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INTERLOCKING DIRECTORATES, THE PROBLEM AND ITS SOLUTION.

IT is only in very recent years that the relationship between the director and the corporation has been receiving serious public attention. The present interest in the subject results from the unusual conditions obtaining since the year 1896. A great change has occurred in business methods and conditions during this period. About fifteen years ago was ushered in an era of expansion in trade and business of every kind. The resources of the nation were unprecedentedly developed and business established upon the largest scale ever known in this country, or perhaps in any other. Apparently it was deemed necessary by those engaged in the promotion of various manufacturing, industrial, and financial enterprises to bring about consolidations and combinations of organizations engaged in the same line of activity but more or less competitive. This brought together in the enlarged organization representatives or former owners of the constituent companies theretofore independent, but by consolidation made into a single unit of influence and operation. It goes without saying that these undertakings could not have succeeded without the supply of ample, and indeed large, financial resources. This requirement brought into the situation banking firms and corporations having a very large public following and influence.

There are two distinct views, each honest and each entitled

to credit for sincerity, with reference to the wisdom of the changed policy as applied to the various commercial, railroad, and financial interests. The one insisting that combination of independent enterprises, heretofore competitive, into large and massive organizations, if continued and persisted in, will work serious and irreparable injury to the nation; that the most important thing for the life and endurance of a nation is the character, the independence and competency of its people; that business is always at hand but men are not; that resources are ever present, but men are required to develop them; that wealth is constantly at our door, but men are needed to gather and utilize it; that these massive combinations impoverish the nation in its constructive business men; that they destroy independence, shatter hopes, and make for a nation of clerks and subordinates, instead of men and masters.

On the other hand, it is claimed, with equal sincerity, that this nation in taking rank amongst the nations of the world must keep pace with the tremendous commercial development of the times, and to do so, must have large means, large facilities, and large and comprehensive organizations, and that this cannot be attained under the competitive conditions which previously existed, but only by establishing larger business and individual units. It is said that though competition in this country may thus be interfered with, greater opportunity for the industries of the nation as a whole, in competing with the industries of other nations, is thereby established and assured.

Be that, however, as it may, combinations and consolidations were made, and therewith came many and serious abuses, some of which were vicious in intent and most of which grew and developed from the very nature of things. It is only within the last few years that the public mind has become alive to the existing conditions. Discontent and unrest have been widespread throughout the land. With these have come an awakened public protest and the nation is brought face to face with some of the most serious problems of the day, namely, the relationship of directors; the abuses of their powers; the violation of their duties, and the liability for their conduct and acts, either of omission or commission. These involve not only the duties, obligations, and liabilities of directors individually, but also of other corporations, having common or dual interests, of which they are also directors.

This awakening of the people has been sudden and the assault has been swift. Those who are the subject of attack had been lulled into security by inaction resulting from ignorance and intimidation. Resting upon that faint security, they have felt themselves buttressed and fortified in law. It is our purpose to demonstrate that the law, instead of furnishing protection and justification for the practices engaged in, will, when promptly availed and diligently enforced, make for the undoing and prevention of what have been misguided, mistaken, or improper practices.

Present Fiscal Practice.

In recent years the practice has prevailed by which financial institutions have become the fiscal agents or issuing houses for corporation securities made to meet the financial requirements, and in the process it usually happens that some representative of such financial institution is a member of the board of directors of the corporation for which it is acting as the fiscal or issuing agency. Knowing how important to the success of any enterprise is the element of financial aid, we can well appreciate, with the fiscal agent at the table of directors, that in the discussion of the financial policy and the financial requirements of the issuing corporation, the influence of such agency is not only persuasive, but dominating. It is, of course, absolute when the fiscal agency is exclusive.

Such a condition is insupportable. It is violative of freedom and independence of business and trade, and is contrary to both law and equity. The corporation does not deal at arm's length with the banking or financial institution thus dominating its directory. There are not two sides to the transaction, and it is clearly one in which the director represents both buyer and seller — a condition so subversive of correct business practice that injury must result to either one or the other, regardless of intention.

We find in this practice banking institutions, through membership on the board of directors, controlling the fiscal policy, and indeed, we may say, the business policy of railroads, manufacturing companies, and commercial enterprises. The result is that these financial institutions very largely control that branch of business

which deals with the issue and negotiation of securities, and not only dominate the issuance and character of the securities, but are able to become the purchasers thereof.

Coincidently, it has been the practice and experience that these same forces, which through directorships in various corporate enterprises dominate the fiscal and business policy thereof, through the same form of relationship influence or control the sources of wealth necessary for these enterprises, *i. e.*, the state banks, trust companies, national banks, and insurance companies.

This is contrary to public policy, is opposed to business fairness, and opens the door to cupidity and fraud. The important life insurance companies doing business in this country annually receive from their policyholders perhaps more than two thousand million dollars. A very large part of these funds must be, and are, invested by the insurance companies. Trust companies and savings banks receive hundreds of millions of dollars of funds which need to be invested, and the state banks and the national banks likewise are the custodians of the people's fortunes, which must be made to earn through the investment market. It follows that insurance companies or financial institutions having funds to put out for investment, through their representatives who at the same time are directors of the selling company, find opportunity for investment immediately at hand.

This condition is not confined to transactions between railroads and industrial companies on the one hand and insurance companies, trust companies, or financial institutions on the other. Similar practice prevails through similar influences and relations concerning trade and commerce among corporations and enterprises engaged in large business, and particularly such as properly would come under the head of interstate commerce.

The forces influencing and dominating boards of directors of corporations engaged in finance, banking, insurance, railroading, and commerce through common or interlocking directorships, restraining and stifling competition and freedom in business, and denying equality of opportunity to all entitled thereto, abuse and violate the fiduciary relation and trust obligation of directors. Some treatment must be found to cure or destroy the evil.

Is there in the law a remedy? If so, can its enforcement be aided? If not, what further legislation is needed?

I. Common-Law Remedies.

The responsibilities and duties of directors and corporations under the law are the same now as they were prior to this era of consolidation. The foundation upon which rest the various elements of power, duty, obligation, and liability of directors is the fiduciary relationship existing between directors and the corporation.

The law-books and the decisions of the highest courts of many of the states and of the United States are replete with text and pronouncements holding that the relationship between a director and the corporation is fiduciary, and that the director for all practical purposes is a trustee, the corporation and its stockholders the *cestuis que trustent*, and the property of the corporation a trust fund.

"The directors of a corporation are ordinarily invested with the most extensive powers of management. They are empowered to represent the company in all of its business transactions and ventures; and the entire corporate affairs are placed in their charge, upon the trust and confidence that they shall be cared for and managed for the common benefit of the shareholders, and in accordance with the provisions of the charter agreement. It is manifest, therefore, that the directors of a corporation occupy a position of the highest trust and confidence, and that the utmost good faith is required in the exercise of the powers conferred upon them." [1]

In the case of Bosworth *v.* Allen [2] it is said:

"While not technically trustees, for the title of the corporate property was in the corporation itself, they were charged with the duties and subject to the liabilities of trustees. Clothed with the power of controlling the property and managing the affairs of the corporation without let or hindrance, as to third persons they were its agents, but as to the corporation, itself, equity holds them liable as trustees. . . . While courts of law generally treat the directors as agents, courts of equity treat them as trustees, and hold them to a strict account for any breach of the trust relation. For all practical purposes they are trustees when called upon in equity to account for their official conduct." [3]

[1] Morawetz on Private Corporations, 2 ed., § 516.

[2] 168 N. Y. 157, 164, 61 N. E. 163, 164 (1901).

[3] See also Barnes *v.* Brown, 80 N. Y. 527, 535 (1880): "It is true that the plaintiff, while

A. *Directors' Disability.*

The fiduciary relationship is so thoroughly regarded as one of trust, that a corporation whose board of directors acts through a quorum of its members will not be permitted to sustain, against protest or objection, any contract or transaction authorized by such quorum, if any director interested in the subject matter of the contract or transaction forms a necessary part of the quorum. The courts, in that respect, hold an interested director to be a stranger to the corporation, and his presence in the meeting as that of a mere bystander, and hence decline to enforce or sustain the action of such a quorum.

The authorities in support of this doctrine are clear, and the language unequivocal.

Thus in Curtin *v.* Salmon River Hydraulic Gold-Mining & Ditch Co.[4] it is said:

"The same rules which preclude an interested director from uniting with other directors in the creation of an obligation in favor of himself by his vote, forbid him from uniting with them in creating such obligation by any act or exercise of his official position; and a meeting at which there is not a majority of the directors, exclusive of such interested director, is not a competent board for the transaction of any corporate business.[5]

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acting as a director of the corporation, held a fiduciary relation to it. He was a trustee of the corporation, and was under the same disability, which attaches to all trustees in dealing with trust property and in transacting the business pertaining to the trust. He could not act as trustee and for himself at the same time, and he would not be permitted to make a profit to himself in his dealings with the corporation. It is against public policy to allow persons occupying fiduciary relations to be placed in such positions as that there will be constant danger of a betrayal of trust by the vigorous operation of selfish motives."

[4] 130 Cal. 345, 351, 62 Pac. 552, 554 (1900).

[5] The court adds: "In Jones *v.* Morrison, 31 Minn. 140, 16 N. W. 854, it was held that a director of a corporation 'cannot properly act on or form part of a quorum to act' on a proposition to increase his compensation.

"In Van Hook *v.* Manufacturing Co., 5 N. J. Eq. 169, the chancellor said that a member of a corporation contracting with it is regarded, as to that contract, as a stranger, and held that, as the corporation was managed by five directors one director could not, with two others constitute a board to vote a mortgage from the company to himself. This case was afterwards reversed upon other grounds but no dissent from this rule was expressed." See also 2 Thompson on Corporations, §§ 1158, 1159.

A very interesting position has been taken by the courts, both in England and

B. *Voidability of Contracts.*

It has been contended, and with some success, that transactions and contracts of corporations in which a director is interested individually or through other corporate connections are not inhibited, unless the particular transaction is authorized by the board through the vote of the interested director; that such interest is immaterial, if it appears that the interested director is only one of a number, and that his confrères authorized the transaction.

This should not be the rule. We cannot close our eyes to conditions as they are. We do know, in modern practice, that one individual director frequently, if not in a majority of cases, is the dominant force in the conduct of corporate affairs. We do know that banking firms and banking institutions, whose representatives are on the boards of directors of different corporations, have a sphere of influence in the deliberations and decisions of such boards of directors that is not measured by the number of votes, but by the power exerted through relations and affiliations of common interest. In law it should be immaterial how many directors vote in favor of a contract or a transaction in which a director, directly or indirectly, has an interest; it should be set aside, and relief granted to the corporation and its stockholders, even though the interested directors refrain from voting.

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in this country, relating to the disability of an interested director, and the right or propriety of his acting as a director when his interest in any transaction or contract with the corporation appears.

In England there is a law — the "Companies Clauses Act" — which provides that whenever it appears that a director of a corporation is interested in corporate matters under consideration by the board of directors, such director, in consequence thereof, is removed from office. See Aberdeen Ry. Co. *v.* Blaikie, 2 Eq. Rep., Pt. 2, 1281, 1291, *et seq.* (1854).

This same subject has been considered in this country, and is referred to in Taylor on Corporations, 4 ed., § 627: "And when a corporate officer finds his personal interests substantially opposed to those of the corporation, then not only on account of the rights of the corporation and his duties to it, but also for the sake of his own security, the plainest course for him is to resign."

The doctrine is supported in the case of Goodin *v.* Cincinnati and Whitewater Canal Co., 18 Oh. St. 169, 183 (1868), where it is said: "A director whose personal interests are adverse to those of the corporation has no right to be or act as a director. As soon as he finds that he has personal interests which are in conflict with those of the company, he ought to resign."

A case in point is Munson *v.* Syracuse, Geneva & Corning R. Co.[6] The court says:

"It can make no difference in the application of the rule in this case that Munson's associates were not themselves disabled from contracting with the corporation, or that Munson was only one of ten directors who voted in favor of the contract. . . . . The law cannot accurately measure the influence of a trustee with his associates, nor will it enter into the inquiry, in an action by the trustee in his private capacity to enforce the contract, in the making of which he participated. The value of the rule of equity to which we have adverted lies to a great extent in its stubbornness and inflexibility."

The trust relationship existing, there should be no doubt of the rule that a director should not deal with his corporation in any matter in which he is interested, directly or indirectly; be the interest in the transaction individual or that of another corporation in which such director is interested, either as an officer, stockholder, or director.

Though the great weight of authority supports the conclusion that contracts made by corporations, in which its directors are interested, either individually or through their affiliations with other corporations, are not void *ab initio*, but merely voidable, yet the rule of law in this respect is such that for all practical purposes, if the contract or transaction be attacked, it will be avoided almost as a matter of course, because the question of the integrity or the good faith of the transaction will not be inquired into. The courts will not consider whether or not the transaction has been injurious. Indeed, they have gone so far as to hold that even where it could be affirmatively shown that the transaction was beneficial to the corporation, yet, the fact of the relationship appearing, the transaction will be set aside, as contrary to public policy and good morals. The decisions in this respect are uniform, and the language is strong and unmistakable.

In Aberdeen Railway Co. *v.* Blaikie[7] it is said:

"So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into. It obviously is or may be impossible to demonstrate how far in any particular case the terms of such a contract have been the best for the *ces-*

[6] 103 N. Y. 58, 74, 8 N. E. 355, 358 (1886). [7] *Supra.*

tuis que trust which it was possible to obtain. It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee have been as good as could have been obtained from any other person; they may even at the time have been better; but still, so inflexible is the rule, that no inquiry upon that subject is permitted."

And in so late a case as Brooklyn Heights Ry. Co. *v.* Brooklyn City R. Co. the court says: [8]

"When the adverse interest is made to appear, the law invalidates all contracts made by the trustee or fiduciary, in which the latter was personally interested, at the election of the party that was represented by him or them. The court said: 'The law permits no one to act in such inconsistent relations. It does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed, and sets aside the transaction or refuses to enforce it, at the instance of the party whom the fiduciary undertook to represent, without undertaking to deal with the question of abstract justice in the particular case.'

"And this rule is applied, even though there be no suggestion of actual fraud in the transaction." [9]

The rule that contracts of corporations with directors who are interested therein may be set aside, applies also to the case of contracts between corporations having common directors. The authorities hold that corporate transactions authorized and entered into between two corporations through the instrumentality of common or dual directorship may be set aside at the instance of either corporation.

Morawetz on Private Corporations [10] says:

"It follows, therefore, that the directors, or other agents of the corporation, have no implied authority to bind the company by making a

[8] 135 N. Y. Supp. 990 (June 7, 1912), quoting from Munson *v.* S., G. & C. R. Co., *supra.*

[9] See Duncomb *v.* New York, H. & N. R. Co., 84 N. Y. 190, 199 (1881): "Nor is it at all questioned that, in such cases, the right of the beneficiary or those claiming through him to avoidance does not depend upon the question of whether the trustee in fact has acted fraudulently, or in good faith and honestly, but it is founded upon the known weakness of human nature and the peril of permitting any sort of collision between the personal interests of the individual and his duties as trustee, in his fiduciary character." See also Barr *v.* New York, L. E. & W. R. Co., 125 N. Y. 263, 274, 26 N. E. 145, 148 (1891).

[10] Sec. 528.

contract with another corporation which they also represent, each company would be interested in obtaining an advantageous bargain at the expense of the other company, and each would have a claim upon the best endeavors of his agents, unbiased by favor to others."

This doctrine was most exhaustively considered in the case of Metropolitan Elevated Ry. Co. *v.* Manhattan Ry. Co.,[11] where in a thorough and well-considered opinion the court said:[12]

"I think, therefore, that the undoubted rule of law in this State is, that every contract entered into by a director with his corporation may be avoided by the corporation within a reasonable time, irrespective of the merits of the contract itself. But we are asked, does this disability extend to the case of a contract between two corporations, some of whose directors hold that office in each corporation?

"I can see no difference in principle between the case of a director contracting with his corporation, and that of directors of one corporation contracting with themselves as directors of another corporation. The evils to be avoided are the same, the temptations to a breach of trust are the same, the want of independent action exists, and the divided allegiance is just as apparent."

A similar situation was presented for judicial investigation and decision in the very recent case of Globe Woolen Co. *v.* Utica Gas and Electric Co.,[13] involving a contract made between two corporations.

In that case the chairman of the executive committee of the complaining corporation had no substantial financial interest therein, but was largely interested in the other party (a corporation) to the contract. At the meeting of the board of directors when the disputed contract was authorized he refrained from voting; nevertheless, his relationship as a director and chairman of the executive committee was regarded as influential and persuasive. The court set aside the contract upon the complaint of the injured corporation, and said:[14]

"In the case at bar it is apparent that the plaintiff's president, through his influence in the management of the defendant corporation, and

[11] 14 Abb. N. Cas. (N. Y.) 103 (1884). [12] P. 272.
[13] 151 N. Y. App. Div. 184, 136 N. Y. Supp. 24 (May 29, 1912).
[14] P. 31.

through his influence as a member of its executive committee, procured or permitted the contracts in question to be entered into, which were of great advantage to the plaintiff, and to himself personally, but which were unduly burdensome upon and altogether unconscionable as to the defendant. . . .

"Nor is it important that plaintiff's president in the transaction in question represented the defendant silently; that he did not openly advocate or vote for the adoption of the contracts. His negotiation of the same implied and carried with it the force and effect of his approval. . . .

The contracts were voidable at the election of the defendant, and so independently of the question whether there was fraud or good intentions on the part of the plaintiff's president in bringing about their consummation."

Also in the case of Brooklyn Heights R. Co. *v.* Brooklyn City R. Co.,[15] the court held invalid and set aside a contract made between two corporations because such was authorized and executed by common officers and common directors.

c. *Accountability for Profits.*

The authorities do not seriously differ as to the right to vitiate and set aside a contract or transaction entered into by a corporation with a director who is directly or indirectly interested therein; but vitiating the undertaking in many instances may work greater injury to the corporation than affirming it.

It is not necessary to disaffirm such a transaction as a basis for relief. The contract may be affirmed and the officer or directors interested required to account for all profits made.[16]

It is the unvarying rule that an agent or a trustee dealing with the property of the principal or *cestui que trust* cannot profit thereby. All directors realizing any profits or benefits from such transactions may be held accountable therefor, and required to surrender them to the corporation.

"Corporate officers may not buy from or sell to their corporation and retain any profits from such transactions, unless the profits are known and the transactions acquiesced in by all who could claim any interest in the profits. For all secret profits derived by them

[15] *Supra.*

[16] Taylor on Corporations, § 631.

from any dealings in regard to the corporate enterprise, they must account to the corporation, even though the transaction may have benefited it." [17]

In Pepper *v.* Addicks [18] the action was by the receiver of the Bay City Gas Company against Addicks, to compel him to pay over certain profits which he was alleged to have made improperly by using the corporate assets for his individual purposes. The court in sustaining the bill says: [19]

"His liability rests upon the fundamental principle that one who occupies a position of trust and confidence — such as the president, or a director, of a corporation — shall never be permitted to abuse his official position by dealing with the corporate property for his private gain. If he so deals, by whatever tortious devices, his acts are voidable if his trail can be followed, and he may be called upon to account for the profits that he has wrongfully made."

And in Wardell *v.* Union Pacific R. Co.[20] the United States Supreme Court says:

"Directors of corporations, and all persons who stand in a fiduciary relation to other parties and are clothed with power to act for them, are subject to this rule; they are not permitted to occupy a position which would conflict with the interest of parties they represent, and are bound to protect. They cannot, as agents or trustees, enter into nor authorize contracts on behalf of those for whom they are appointed to act and then personally participate in the benefits." [21]

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[17] Taylor on Corporations, § 629. See also Morawetz on Private Corporations, 2 ed., § 518.

[18] 153 Fed. 383 (1907).

[19] P. 405.

[20] 103 U. S. 651 (1880).

[21] See also Gilman, Clinton & Springfield R. Co. *v.* Kelly, 77 Ill. 426, 432 (1875): "The vital question is, whether it was lawful for any number of the directors of the railroad company to become members and stockholders in the Morgan Improvement Company, with whom they had a construction contract. Whether the contract was originally valid, is not now an important subject of inquiry; for if it was illegal for the directors to become members of the construction company, and participate in the profits, if any should be realized, that fact would establish a right in complainants to have an account taken, as clearly as though the contract, in the first instance, was unlawful. The same conclusion would inevitably follow, and the result, so far as the participating directors are concerned, would be the same.

"We are inclined to adopt the latter view, viz.: that no director could rightfully

The rule that a director may not profit from any transaction with the corporation in which he is interested applies also to a corporation or partnership or association, whose officers, directors, members, or agents are represented in the other company's board of directors.

This is a remedy that is swift and wherein a recovery is reasonably certain, but there may be instances in which legitimate business would be seriously hampered and interrupted if this rule is unreasonably applied. For instance, it might be carried to the extreme of establishing liability for profits by way of interest on loans or deposits of corporations with banks having common directors, or the customary and usual business profits of companies engaged in manufacturing or commercial enterprises, having common directors. The application of the rule to such cases would be unjust and injurious instead of helpful and right. It may be, therefore, that some other rule of recovery should be considered, such as actual damages sustained, or undue profits gained.

Silence of Directors.

Ordinarily, where provision is made in any statute requiring *assent* as a basis for personal liability of a director, the courts have, in giving construction thereto, almost uniformly held it to be necessary that some affirmative act or some positive conduct on the part of a director be established as a basis for liability. But in the case of Patterson *v.* Stewart [22] we find that the assent on the part of the director was spelled out of his course of conduct, without any affirmative or positive action being disclosed. The court in that case, after defining what may be regarded as assent, says the following: [23]

"This assent, however, need not be express. If a director knew that a violation of law was being or about to be committed, and made no objection, when duty required him to object, and when he had the opportunity of doing so, this would amount to 'assent.'"

become a member of the improvement company, with whom the railroad company had a contract to furnish the means with which to build the road, with a view to share in the profits, and that if any gains should be realized in the enterprise, they would belong to the railroad company, upon the equitable principle which forbids the trustee, or person acting in a fiduciary capacity, from speculating out of the subject of the trust."

[22] 41 Minn. 84 (1889). [23] P. 94.

The force of this ruling becomes apparent in view of the generally accepted doctrine that if a director who is interested in a transaction under consideration by the board be present and bring to bear the influence of his membership, but refrains from voting, his non-action will relieve him from obligation.

Directors should not be permitted to relieve themselves of responsibility by merely remaining silent. It is the duty of the director to disclose to his fellow directors his interest in the transaction in hand as well as all the benefits and advantages accruing to him therefrom. If he cannot or will not do this, he should resign from the board, relieve the directors of the influence of his presence and membership and enable the board to deal with him at arm's length.

This has not been the practice. Generally the interested director is present at the meeting, exerting the influence of his membership in the board, and then seeks to relieve himself of responsibility by having the record show him "not voting."

This case of Patterson *v.* Minnesota Manufacturing Co. deals with the situation in a way that should put an end to this circumvention of the legal consequence by silence, construing such conduct of a director into an assent, and visiting upon the interested director the consequences either of having the transaction set aside, if the corporation sees fit to do so, or of holding the director liable for whatever profits may come to him as a result of that undertaking.

It is the right of every corporation to have disinterested counsel and unbiased discussion from every director; and it is his duty to those who are not informed to disclose fully his interest in and knowledge concerning any transaction before the board of directors for action.[24]

II. Proposed Statutory Remedies.

Proceedings against officers and directors of corporations arising out of contracts and transactions of the company in which such officers or directors were interested have been very infrequent.

[24] The following pertinent language in this regard from Aberdeen Ry. Co. *v.* Blaikie, *supra*, p. 1287, is applicable: "It was Mr. Blaikie's duty to give to his co-directors, and through them to the company, the full benefit of all the knowledge and skill which he could bring to bear upon the subject."

Although the last fifteen years of corporate organization and management are replete with transactions of the character condemned under the rules dealing with fiduciary relations, yet the records of the courts are singularly free of actions of this kind. Why is this so? The answer is not difficult to find.

First. The stockholders and parties in interest are kept in ignorance of the transactions and proceedings of the company, especially of the matters in which the directors, directly or indirectly, are interested.

Second. The stockholders are unable to produce the necessary evidence to substantiate any complaint and are consequently disinclined to proceed.

Third. Even if possessed of knowledge and information and the necessary evidence to prove the charge, yet there is failure to act, due to fear of reprisal; or to intimidation from sources of power and influence; or to timidity because of possible injury resulting from unknown directions; or to apprehension of the untoward consequences which may befall one who complains, at the hands of those forces and affiliated interests which through common directorships and interlocking relations can wield unlimited power for retaliation and destruction.

It is necessary to find the means and machinery to deal effectively with such a situation.

(*a*) The first remedy to prevent unjust discrimination and avoid undue advantage is to enact laws, national and state, forbidding any person who is a bank director to be either an officer or director in another bank or in any insurance company or in any railroad or industrial company with which his bank has interests which may conflict or business relations of a fiduciary character, and this should apply to those who are members of banking firms or financial institutions; and it should also be the rule that no person who is a director or officer of any corporation shall be a director in any other company with which it has relations of such a character as to tempt or induce or make possible a violation or disregard of the fiduciary responsibility which such a director or officer would owe to both corporations.

Apropos of this, Mr. Justice Field said, in Wardell *v.* Union Pacific R. Co.:[25]

"It is among the rudiments of the law that the same person cannot act for himself and at the same time, with respect to the same matter, as the agent for another whose interests are conflicting. The two positions impose different obligations, and their union would at once raise a conflict between interest and duty; and constituted as humanity is, in the majority of cases duty would be overborne in the struggle."

(*b*) There should be legislation which will prohibit any railroad company, insurance company, bank, trust company, or industrial company, establishing or permitting an exclusive or sole fiscal agency or relationship, which will either prevent or lessen freedom of competition in any and all corporate transactions.

(*c*) There should be legislation requiring the president of every corporation to make report annually to the stockholders, of every contract made by the corporation in which any director has any interest, directly or indirectly, or with any corporation of which any of its directors is a member and has any interest, setting forth the contract and the exact nature of the transaction, and covering in detail the undertaking and its terms and conditions. This report should be sworn to by the president of the company, and untruthfulness therein should be punishable as for perjury. A duplicate copy of such report should be properly verified, and filed with the Comptroller of Currency and Interstate Commerce Commission at Washington, and with a similar body in the state where the company has its principal executive office.

These reports should be referred to the Attorney-General of the United States or of the state, as the case may be, whose duty it shall be promptly to make examination thereof, and if there are therein disclosed contracts and transactions in which directors are interested or in which some other corporation or partnership or association, represented on the corporation's board of directors, is interested, take prompt action to vitiate all such contracts and transactions and recover any damages sustained, or if deemed wise, without disaffirming the contract or transac-

[25] *Supra.*

tion, proceed against the interested directors, corporation or partnership for all profits derived therefrom.

(*d*) For failure of the president of the corporation to make the report, he should be made liable for any damages suffered by the corporation, and also adjudged guilty of a misdemeanor, with severe penalties.

(*e*) To assure further against failure or neglect to make such reports, it should be made the duty of every state and national bank examiner and every state superintendent of insurance and the Interstate Commerce Commission to examine the records of every bank and every insurance company and every trust company, and every railroad company and every corporation engaged in interstate commerce, including the minutes of the stockholders' and directors' proceedings, and upon it appearing that any contract or transaction had been entered into, in which any director was interested, or with a corporation or partnership or association, in which a director was interested, that fact should be brought to the attention of the attorney-general of the state in case of a state institution, and the Attorney-General of the United States where the corporation is within the federal jurisdiction, whose duty it should then become instantly to proceed, as above suggested.

(*f*) It should be made the duty of the corporation, acting through its officers and directors, upon its own initiative, and without the necessity of prior request from stockholders, to set aside and annul any transactions, contracts, and undertakings with a director or in which any director has any interest, whether individually or for the benefit of any firm of which he is a member, or with which he is connected, or of any corporation in which he is interested or of which he is a director, and recover from such director or such firm or such corporation, any damages sustained; or, if the interests of the company require, affirm the transaction and proceed against such director or such firm or corporation to recover, by enforcement of personal liability, all profits secured in such transaction, unless such contract or transaction has been reported to the stockholders and by them approved. That duty should be an active one, and if the officers and directors fail to assert the rights of the corporation in that regard, they should be made liable for any damages which the corporation may sustain by their inaction and failure in that regard.

Legislation Supporting such Procedure.

In the course of our investigations we have found legislative action by the state of New York as long ago as the year 1825 providing some of the remedies above suggested for dealing with the existing vulnerable practice. Means for relief were there afforded to injured corporations or stockholders without the interposition of some individual, who either as stockholder or otherwise had been the victim of improper and illegal corporate transactions and who, because of fear of possible reprisals or attack by powerful interlocking interests, could not risk independent action.

The attorney-general of the state of New York under that law not only was empowered, but it was his duty, in behalf of the people of the state to bring to account corporations and the officers and directors of corporations transgressing and violating their duties and obligations.[26]

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[26] See N. Y. Rev. Stat., 1775, Pt. 3, c. 8. The following sections are applicable to this subject:

"Sec. 33. The chancellor shall have jurisdiction over directors, managers, and other trustees and officers of corporations.

"1. To compel them to account for their official conduct, in the management and disposition of the funds and property committed to their charge:

"2. To decree and compel payment by them, to the corporation whom they represent, and to its creditors, of all sums of money, and of the value of all property which they may have acquired to themselves, or transferred to others or may have lost or wasted, by any violation of their duties as such trustees:

"3. To suspend any such trustee or officer from exercising his office, whenever it shall appear, that he has abused his trust:

"4. To remove any such trustee or officer from his office, upon proof or conviction of gross misconduct:

"5. To direct new elections to be held by the body or board duly authorized for that purpose, to supply vacancies created by such removal:

"6. In case there be no such body or board, or all the members of such board be removed, then to report the same to the Governor, who shall be authorized, with the consent of the senate, to fill such vacancies:

"7. To set aside all alienations of property made by the trustees or other officers of any corporation, contrary to the provisions of law, or for purposes foreign to the lawful business and objects of such corporation, in cases where the person receiving alienation, knew the purpose for which the same was made: and,

"8. To restrain and prevent any such alienation in cases where it may be threatened, or there may be good reason to apprehend it will be made.

. . . . . .

"Sec. 35. The jurisdiction conferred by the preceding thirty-third section shall be exercised as in ordinary cases, on bill or petition, as the case may require, or the

On several occasions this legislation was the subject of judicial inquiry, and received very thorough investigation and consideration; and the right and duty of the attorney-general to act on his own initiative was finally sustained in two well-considered and most thoughtful opinions in the case of People *v.* Ballard.[27] Attention is drawn to the following language from the opinion of Justice Vann:

"Has the state no interest in supervising the conduct of its creatures to whom it has confided such great power? In a broad and political sense, has it no interest in requiring the managers of corporations to observe their charters, and not abuse their powers? Has it no interest to prevent, by the deterrent effect of example in a flagrant case of wrong, similar violations of law by those managing other corporations? May not the Legislature have thought that sound public policy required not only remedies for the redress of private wrongs to be enforced at the instance of those injured, but also the direct interference by the state whenever, according to the sound judgment of a discreet and conservative public officer, it was necessary, in order to arrest a growing evil? These questions, we think, suggest an answer to the argument founded on the supposed improbability that the Legislature would depart from the usual rule of requiring a direct interest to support an action. No such interest was regarded as necessary in order to annul a charter, dissolve a corporation, remove a receiver, or oust a usurper. With great deference to the learned judges who have reached a different conclusion, and whose opinions have caused us to hesitate long and anxiously before pronouncing judgment, we think that this action, if otherwise well founded, can be maintained by the attorney-general in the name of the people alone."

In 1880 this Act of 1825 was repealed.[28] But in the year 1909 a number of the important provisions of the repealed legislation were reënacted, and, so far as applicable to this subject, are found incorporated in sections 90 and 91 of Article V of the General Corporation Law of the state of New York. Though the powers of the

chancellor may direct, at the instance of the attorney general prosecuting in behalf of the people of this state, or at the instance of any creditor of such corporation, or at the instance of any director, trustee, or other officer of such corporation having a general superintendence of its concerns."

[27] 134 N. Y. 269 (1892). One of these opinions was by Justice Peckham, thereafter one of the judges of the United States Supreme Court, and appears by way of footnote at page 272. See especially pp. 283, 284.

[28] See New York, Laws of 1880, c. 245.

attorney-general are considerably circumscribed, yet this law as it stands is available and useful for remedy and relief against many of the existing abuses, and can be made the basis of further legislation on the subject.[29]

Generally speaking, the state should not interfere in the affairs of a purely private corporation, and the exercise by the attorney-general of the broad powers conferred should be wisely defined so as to prevent undue activity except in extreme cases, as is clearly stated by Justice Peckham in People *v.* Ballard:[30]

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[29] N. Y. Consol. Laws, c. 23 (Laws of 1909, c. 28) § 90. "*Action against officers of corporation for misconduct.* — An action may be maintained against one or more trustees, directors, managers, or other officers of a corporation, to procure a judgment for the following purposes, or so much thereof as the case requires:

"1. Compelling the defendants to account for their official conduct, including any neglect of or failure to perform their duties, in the management and disposition of the funds and property committed to their charge.

"2. Compelling them to pay to the corporation, which they represent, or to its creditors, any money, and the value of any property, which they have acquired to themselves, or transferred to others, or lost, or wasted, by or through any neglect of or failure to perform or by other violation of their duties.

"3. Suspending a defendant from exercising his office, where it appears that he has abused his trust.

"4. Removing a defendant from his office, upon proof or conviction of misconduct, and directing a new election, to be held by the body or board duly authorized to hold the same, in order to supply the vacancy created by the removal; or where there is no such body or board, or where all the members thereof are removed, directing the removal to be reported to the governor, who may, with the advice and consent of the senate, fill the vacancies.

"5. Setting aside an alienation of property, made by one or more trustees, directors, managers or other officers of a corporation, contrary to a provision of law, or for a purpose foreign to the lawful business and objects of the corporation, where the alienee knew the purpose of the alienation.

"6. Restraining and preventing such an alienation, where it is threatened, or where there is good reason to apprehend that it will be made.

"7. The court must, upon the application of either party, make an order directing the trial by a jury of the issue of neglect or failure of defendants to perform their duties; and for that purpose the questions to be tried must be prepared and settled as prescribed in section nine hundred and seventy of the code of civil procedure.

"As to any litigation pending prior to September one, nineteen hundred and seven, the provisions of this section as they existed prior to that date shall apply."

"Sec. 91. *Who may bring such an action.* — An action may be brought, as prescribed in the last section, by the attorney-general in behalf of the people of the state, or, except where the action is brought for the purpose specified in subdivision third or fourth of that section, by a creditor of the corporation, or by a trustee, director, manager or other officer of the corporation, having a general superintendence of its concerns."

[30] 134 N. Y. 269, 286, 287 (1892).

"Where the corporation is a purely private manufacturing, trading, or other business corporation, the case would, as we think, have to be a most extraordinary one to warrant the attorney-general in the interests of the public in bringing an action to set aside alleged illegal transfers of property in which the people had no interest, and a recovery in which would benefit only those who claimed to own the property or some part or portion or interest therein."

But as to transactions and affairs of corporations having vast interests and charged with responsibilities to the public, and in connection with which the powers of visitation are granted by the state and nation, such as insurance companies, banking corporations, trust companies, and railroads, and other corporations engaged in interstate commerce, the right and duty and the power of the attorney-general to interfere for the protection of the corporation and its stockholders and the public interest should be as comprehensive as possible. And was it not that class of corporations which Justice Vann had in mind when writing his opinion in People *v.* Ballard?

The public has a very lively interest in railroads, in public utilities, in banks, in insurance companies, and the very large enterprises engaged in interstate commerce. Their affairs concern not only stockholders, but the people. Such public interest has been recognized by the state and nation in exercising supervisory control over banks and trust companies through the banking departments, over the insurance companies through the insurance department, over public utilities through the public service commissions, and over the railroads through the interstate commerce and railroad commissions.

It is only one step further, and a proper step, to permit the law officer of the state or nation, as the case may be, in the interest of corporations charged with a public interest and owing duties to the public, and in the interest of the stockholders, upon his own initiative, to undo illegal acts and transactions of the corporations and to redress wrongs committed by the officers, directors, and managers thereof.

The fear of unseen danger to a stockholder seeking openly to protect the corporation and himself would be dispelled, and the menace of reprisal and retaliation at the hands of concentrated or affiliated power would be avoided, by the enforced reports

required to be made by the president to the stockholders and filed with the proper public authorities; and relief secured through action by the attorney-general without the necessity for independent action by stockholders or other injured persons.

A similar question was presented to the Supreme Court of Wisconsin in the case of State *v.* Milwaukee Electric Railway & Light Co.[31] The court there declined to follow People *v.* Ballard, because the statute of Wisconsin differed from the New York statute and specifically provided "that every action shall be prosecuted in the name of the real party in interest."

The Supreme Court of the United States considered the subject by analogy in the case of United States *v.* Union Pacific R. Co.,[32] which was based on a special act of Congress directing the action taken.

III. Is the Sherman Act Applicable?

Another remedy for dealing with this very serious subject, which is submitted for consideration, is to invoke the benefit of the Sherman Anti-Trust Law. The conditions existing and here considered deal in a way with a subject coming within the operation of the Sherman Act. There exist through the instrumentality of common or dual directorships in various corporations, such as state banks, national banks, trust companies, insurance companies, and railroad companies, and their bankers and fiscal agents, combinations or understandings by which the fiscal and business policy of such corporations relating to the issue and negotiation of securities are controlled. This is evidenced by the establishment of exclusive fiscal agencies and by a well-recognized and persistent course of conduct under which securities are issued and marketed without competition. The vast fortunes available for investment should be accessible to the demands of business requirements throughout the land, and not confined largely to those bankers and financial institutions constituted the fiscal agencies and issuing houses under the dominating influence of interlocking interests and directorships. The thousands of millions of funds contributed by the inhabitants of this country to insurance companies, savings

[31] 136 Wis. 179, 160 N. W. 900 (1912).
[32] 98 U. S. 569 (1878).

banks, and trust companies are largely turned over to these same banks and banking institutions and fiscal agencies for investment in securities the issue of which they themselves control by reason of their relation to the issuing corporations, without competition. The issuing company should be afforded a competitive market for its securities by public offer or otherwise. Likewise, the investing company should be enabled to invest its funds freely in all directions instead of turning them over by the millions without competition from any source.

It may be said that the Sherman Act cannot be availed for the reason that the negotiation of securities is not interstate commerce, even when issued by corporations engaged in interstate commerce. This is true, but if the securities issued and the funds supplied are for the express purpose of, and use in, the operation of railroads and corporations engaged in interstate commerce, — in the case of railroads for the purchase of rails, for the building of roads, for the purchase of cars and equipment, all of which are used in interstate commerce, and in the case of industrial and commercial enterprises engaged in interstate commerce, in connection with the manufacture and sale and delivery of commodities through the channels of interstate commerce, — then the Sherman Act might be invoked. For instance, "car trusts" or "equipment notes" are obligations expressly issued and negotiated to pay for cars and equipment to be used to carry on and conduct interstate commerce.

In Mondou *v.* New York, New Haven & Hartford R. Co.[33] we have a definition of interstate commerce which shows the comprehensiveness of its application. The Supreme Court there quoted with approval from the brief prepared by Lloyd W. Bowers, Esq., then Solicitor-General of the United States, the following:

"Interstate commerce — if not always, at any rate when the commerce is transportation — is an act. Congress, of course, can do anything which, in the exercise by itself of a fair discretion, may be deemed appropriate to save the act of interstate commerce from prevention or interruption, or to make that act more secure, more reliable, or more efficient. The act of interstate commerce is done by the labor of men and with the help of things; and these men and things are the agents and instruments of the commerce. If the agents or instruments are destroyed

[33] Second Employers' Liability Cases, 223 U. S. 1, 32 Sup. Ct. 174 (1912).

while they are doing the act, commerce is stopped; if the agents or instruments are interrupted, commerce is interrupted; if the agents or instruments are not of the right kind or quality, commerce in consequence becomes slow or costly or unsafe or otherwise inefficient; and if the conditions under which the agents or instruments do the work of commerce are wrong or disadvantageous, those bad conditions may and often will prevent or interrupt the act of commerce or make it less expeditious, less reliable, less economical, and less secure. Therefore, Congress may legislate about the agents and instruments of interstate commerce and about the conditions under which those agents and instruments perform the work of interstate commerce, whenever such legislation bears, or, in the exercise of a fair legislative discretion, can be deemed to bear, upon the reliability or promptness or economy or security or utility of the interstate commerce act."

We do not want to be understood as advocating the immediate availability of this remedy, but we do insist that there is apparent a condition, participated in by various institutions, individuals, and agencies through their representation on the boards of directors of banks and trust companies and insurance companies and in railroads, manufacturing companies and in industrial and commercial enterprises working together through exclusive fiscal and business agencies and through a consistent and long-continued course of conduct, apparent in the daily financial and business operations and practices of the large corporate interests and enterprises, which irresistibly leads to the conclusion that business freedom and equality of opportunity are seriously hindered and stifled through the domination of interlocking interests represented by common and dual directorships, and that this condition needs attention and correction.

Conclusion.

The uniform rule that the fiduciary relation of a director constitutes him for all practical purposes a trustee; the jealousy with which courts scrutinize every transaction in which a trust relationship exists; the legal presumption of fraud in every transaction in which a director is interested,—assure relief in the courts. Contracts made with a director, or in which he is interested either directly or as the representative of an interested party to the contract, will be subject to vitiation instantly the relationship of

the director to the transaction is disclosed, and at the election of the complaining corporation damages sustained may be recovered or the transaction may be affirmed, and all profits derived therefrom accounted for. The leaven of personal liability on the part of directors is a most potent corrective of the objectionable practices. There are, therefore, various forms of relief available under the law as it now stands.

It may be said that the enforcement of personal liability would produce a prevalence of dummy directors. It is likely that here and there such a subterfuge may be successful, but the success would only be temporary. Vigilant investigation and vigorous prosecution would soon turn up the undisclosed principal. That done, the remedy against both the dummy director and his principal will be swift and certain.

"In America the relation of the real owner to the 'dummy' is held to be that of principal and agent, and the principal is held liable on the ground that an undisclosed principal is liable on the contracts of his agent." [34]

The public is not in a mood to tolerate subterfuge in dealing with trust relationships. Before the power of awakened public opinion, cupidity hesitates and recreancy disappears.

The surest remedy, however, for combating and overcoming the abuse of the fiduciary relation of directors, whether through the power and influence of interlocking interests represented by common and dual directorships, or otherwise, lies in publicity and in public vigilance. Publicity of all corporate transactions in which any director is interested, either directly or as the representative of some other corporation or interest, through reports by the officers as above suggested, supplemented by the investigation and examination of all corporate records by the proper bodies having visitorial power, either state or national, will serve quickly and materially to lessen and retard existing abuses of the fiduciary relation of directors.

Vigilance on the part of the law officers of the state or nation, and vigorous prosecution to set aside and undo illegal and improper

[34] 1 Cook on Corporations, 6 ed., § 253. See National Foundry & Pipe Works *v.* Oconto Water Co., 68 Fed. 1006, 1013 (1895), where it is said: "A stockholder cannot escape liability by the use of the name of a dummy."

corporate transactions, coupled with the infliction of such penalties as the law affords, whether by enforcing personal liability against those responsible for abuses and violations or invoking more drastic prosecutions, will serve ultimately to prevent the continuation of officers' and directors' indifference to and disregard of their obligations of trust.

No director is true to his obligation of trust who permits his action as a director to be controlled by influences and forces whose interests do or may, or allows his personal interest to, conflict with those of his corporation. Lack of publicity and lack of vigilance must be charged largely with the responsibility for the violations of the fiduciary relation of directors. To preserve a wholesome respect and a high regard for the trust reposed in those who have the charge and the management of trust property, there must be sustained public vigilance. The vigorous pursuit of the remedies already afforded in the law; the inhibition of dual or interlocking directorships; the enforced publicity of corporate actions and transactions in which directors are interested either directly or representatively; vigilance by the proper authorities in state and nation; the vigorous prosecution of corporate abuses,—can and will end the recreancy and improper practices developed in the last decade, establish a proper appreciation of the obligations resting upon those occupying fiduciary positions, stimulate a proper regard for the trust and confidence reposed in a trustee, bring a higher standard of business practice, and win back — what is now lacking — the confidence of our people in the integrity and reliability of our men of affairs.

Many of the abuses and conditions calling for correction might have been, and could still be, avoided without governmental interference. The business interests of the country are quite capable of dealing effectively with the situation, though they have not heretofore done so. Failing in effort to set right the abuses and illegal practices so generally indulged in, the only recourse left to curb or cure existing economic evils is to invoke the aid of legislative and governmental intervention.

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